The Importance of Transparency

A review of the public disclosure rules

by Lloyd Mayer

The Enron scandal has drawn renewed attention to ensuring that the financial statements of for-profit companies accurately reflect financial reality. It should also serve as a wake-up call to nonprofit organizations, which can be just as vulnerable to financial smoke and mirrors.

The Baptist Foundation of Arizona, an agency of the Arizona Southern Baptist Convention, collapsed in 1999 after the discovery by state investigators of numerous fraudulent transactions. The Arizona Attorney General has estimated that its collapse has cost persons who invested in the Foundation upwards of $500 million.

The former head of the Hale House for children was forced to resign last year amid allegations of financial improprieties. She and her husband now face criminal charges for allegedly stealing over a million dollars from the charity, including funneling money through a fictional "Hale House Foundation."

In both the Baptist Foundation and Hale House cases, the suspect transactions had been going on for many years before they became known to most board members and to outside investigators.

What can nonprofit officers and board members do to prevent such scandals? One important step is to ensure that their organization is "transparent"—that its finances and activities are readily visible to the organization's board, its donors, and the public. There are several steps they can take to ensure such transparency:

1. Ask the right question. The most common approach to transparency is to ask, "What do we have to disclose?" The problem with this question is it assumes that the default position is secrecy—that unless there is a clear requirement that certain information be disclosed, that information should be kept secret.

A better question is, "What, if anything, do we need to keep confidential?" This question assumes that the default position is disclosure.

This default position flows directly from biblical principles. "This is the verdict: Light has come into the world, but men loved darkness instead of light because their deeds were evil. Everyone who does evil hates the light, and will not come into the light for fear that his deeds will be exposed" (John 3:19-20 NIV). The more of its activities and finances that an organization keeps secret by reserving knowledge about those activities or finances to a limited group of people, the greater the opportunity for misdeeds. Disclosure, in contrast, helps create accountability, both within the organization and to donors and the public.

> *"Transparency is an important step to prevent scandals."*

2. Obey the law. Most nonprofit organizations, with churches being the major exception, are required to file an annual information return (Form 990 or 990-EZ) with the Internal Revenue Service. This return asks for detailed financial information, including the compensation paid to officers, directors, key employees, and highly-compensated staff. As with all tax returns, nonprofit organizations are required by law to provide complete and accurate information on this return.

The IRS makes this return available (for a modest fee) to anyone who requests a copy. The IRS has also made all returns for charities available to Philanthropic Research, Inc., which posts them at www.guidestar.org. The increased visibility of these returns has led to more than one organization having to face uncomfortable questions from the media or critics because the information they provided on their return does not appear to match their actual activities or finances.

Nonprofit organizations are also required to provide copies of their three most recent returns to any person who asks for them. The copies must be provided on the same day in response to in-person requests and within 30 days in response to written requests. As an alternative to providing copies, the organization may make those returns available on its Web site and refer requesters to that site. These same rules also apply when someone requests a copy of an organization's IRS exemption application.

Most nonprofit organizations also make various state and local filings. These filings are generally a matter of public record. State and local governments are also beginning to post such filings on the Internet, making them more accessible.

3. Follow ECFA's requirements. ECFA members are required to provide their most recent audited financial reports to anyone who requests a copy. ECFA members are also required to be truthful in all fund-raising communications, including information related to their financial status.

Benefits of Transparency

Being transparent serves to deter improper diversions of funds and other misdeeds. It also provides a defense to critics and a witness to both believers and non-believers.

When Jesus was arrested, he said to the crowd, "Am I leading a rebellion, that you have come out with swords and clubs to capture me? Every day I sat in the temple courts teaching, and you did not arrest me" (Matthew 26:55 NIV). By doing so, he contrasted the openness of his public actions with the secrecy of his middle-of-the-night arrest.

Paul cites the fact that his deeds were done openly as one basis for his authority over the Thessalonians. "You are witnesses, and so is God, of how holy, righteous and blameless we were among you who believed" (1 Thessalonians 2:10 NIV). Having nothing to hide provides credibility and authority.

It is also foolish to believe that because an activity is done secretly, it will remain secret. "Nothing in all creation is hidden from God's sight. Everything is uncovered and laid bare before the eyes of him to whom we must give account" (Hebrews 4:13 NIV). As the Enron, Baptist Foundation, and Hale House situations show, accountability may also come in the more earthly form of government investigations and criminal indictments.

> ***"Transparency is a witness to both believers and nonbelievers."***

What Should Not Be Disclosed

Should everything a nonprofit organization does be disclosed? Not necessarily. There are privacy and legal concerns that may require an organization to keep certain information confidential.

One example involves the names of donors to the organization. Congress has recognized the importance of donor privacy by requiring the IRS to redact the names and addresses of contributors before releasing the Forms 990/990-EZ of nonprofit organizations. Nonprofit organizations should similarly redact this information before providing copies of these forms to the public. They also should generally redact this information before providing copies of these forms to state or local authorities, as most states and local governments do not have procedures in place to prevent the public release of this information. Disclosure of donor names with the permission of the donors is, of course, permitted.

Another example is the identity of recipients of certain grants or other aid. If an organization makes grants to low-income persons who are HIV positive, it should keep confidential the names of the specific recipients (and may be required to do so by law). Similar concerns exist with respect to medical patients generally and also, in some circumstances, to individual recipients of scholarships and other financial aid. Similar reasons for confidentiality will often exist for deliberations about strategic or legal decisions, and for data about employees.

Information that should be disclosed, however, is the compensation paid to directors, officers, and other senior staff of a nonprofit organization. In fact, nonprofit organizations are required to disclose this information on their IRS Forms 990/990-EZ. Failure to do so completely and accurately can lead to significant penalties.

Will being transparent prevent all scandals? No. But it will provide a strong deterrent to any potential wrongdoers, while at the same time helping your organization maintain its witness and its credibility with the public.

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